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$165 BILLION IN RED INK: THE EYE OF THE HURRICANE

by Philip M. Crane

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Congressman Crane delivered this address on the Hillsdale campus in the Ludwig von Mises Lecture Series.

As an alumnus of Hillsdale it is always a pleasure to return for whatever reason. But to be asked to participate in your Ludwig von Mises Lecture Series is a particular honor. Von Mises was indeed one of the towering economic thinkers of his or any other generation. I can only hope that were he here today, he would endorse what I have to say.

Be that as it may, of one thing I am sure–von Mises would be horrified at the size of the most recent federal budget deficits. When I was asked to give this talk, those deficits–the ones for the fiscal years 1975 and 1976 and the one expected in fiscal 1977–came to $165 billion. Now, thanks to a slight decrease in 1976 outlays from previous estimates, that figure is down to $160 billion. But that does not include off-budget items such as the Export-Import Bank or liabilities accrued during the year but not payable until sometime in the future, such as Social Security.

As a matter of fact, the Treasury Department just published a prototype consolidated financial statement last month, based on fiscal 1975 figures. It estimated that the deficit in fiscal 1975 was $152 billion, instead of $43 as the final budget figures for that year showed. So, we are really talking about more than a $160 or $165 billion deficit–far more–but even if it were only $165 billion, such a figure would be, and is, fraught with the most serious of implications.

The first of these implications involves the individual taxpayer–you and I, and millions of other hard-working middle class Americans who are getting hit harder and harder each year by taxes.

How hard? Well, each year the Tax Foundation in New York does a study of federal, state, and local taxes and then tells us how long it will be before we start working for ourselves. Last year, it was estimated that the average taxpayer worked from January first to May first just to pay his taxes. Or, to put it in another perspective, two hours and thirty-nine minutes–just about one-third–of every eight-hour working day was consumed *paying taxes*, with one hour and forty-one minutes of that going to pay federal taxes. Taxes are the largest single item; in fact, the next biggest category, housing and household operation, consumed only one hour and thirty-two minutes.

Actually, the Tax Foundation may be a little conservative in its estimate of what the total federal, state, and local tax take is each year. I've seen other estimates to the effect that such tax collections have risen from 13 percent of national income in 1929, to 26 percent in 1950, to 38.6 percent in 1973, to

im•pri•mis (ĭm-prī´ mĭs) adv. In the first place. Middle English, from Latin <u>in primis</u>, among the first (things). . .

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over 40 percent today. And the expectation is that, unless the trend is reversed, by 1985 the share of national income taken by all levels of government will increase to 54 percent.

This increasingly large tax bite leads us to the second of the aforementioned implications: capital starvation in the private sector. Many experts agree that, over the next decade, the U.S. economy will need roughly $4.5 trillion in investment capital (or $21,000 per person) to keep our economy prospering. Whether one agrees with the findings of the New York Stock Exchange study, which suggests a capital shortfall of $650 billion, or the Chase Manhattan Bank study, which says we will have a $1.5 trillion capital shortage, the fact remains that the nation generated only $1.5 trillion in investment capital in the last decade. Thus, the very least that can be said is that over the next decade, we will need to do three times as well in capital formation as we have done over the last ten years.

The sad fact of the matter is that the United States has the lowest rate of capital investment among the major industrialized nations of the world. From 1960 to 1973, the percentage of private investment in the United States relative to GNP was only 18 percent, compared to 22.4 percent for Canada, 26.2 percent for West Germany and 33.4 percent for Japan which led the field. Concurrently, the growth in productivity in the U.S. averaged only 3.3 percent per year over that period compared to 4.3 percent for Canada, 5.8 percent for West Germany and 10.5 percent in Japan. It should also be mentioned that Britain, which had the next lowest growth rate among the aforementioned nations, also had the next lowest percentage of private investment—18.9 percent—and you know what shape their economy is in.

Just as these figures strongly suggest that growth in productivity is dependent to a large extent on the level of capital investment, it also stands to reason that employment is a function of productivity. If the growth in productivity does not keep pace with the growth in the work force, or worse yet declines, unemployment will increase.

In raw numbers, the Treasury Department has estimated that we will need about twenty million new jobs by 1985, or seven million more than were created in the last ten years, if we are to have a full-employment economy. Thus, if our current unemployment rate is to be reduced, or kept from going higher, there are two ways to go—either we give the private sector the incentive and the means to create these jobs at no expense to the taxpayer, or we have the federal government provide make-work jobs that only add to the budget deficits.

Creating jobs is not an easy business, particularly if they are productive jobs. At the time President Ford vetoed the Public Works Employment Bill last February, and again last July, it was pointed out that it would cost the American taxpayers $25,000 for each $8,000 job created. And the jobs would be temporary and in most cases not all that productive. By contrast, it costs upwards of $45,000 to create a new productive job in the private sector, due to the need for heavy investment in sophisticated equipment and technology. But once created, the job will provide a career for the new employee while increasing the supply of goods to the consumer. Moreover, tax incentives for capital formation and job creation in the private sector have been shown by previous experience—in the U.S. in 1964 and in Canada just recently—to increase tax revenues relative to expenditures rather than to decrease them, as is inevitably the case when the federal government provides the employment.

Common sense dictates that what we should be doing is developing capital formation incentives to deal with the impending capital shortfall, whether it be $650 billion or $1.5 trillion, instead of toying with counterproductive proposals such as the Humphrey-Hawkins so-called full employment bill. Depending on who you talk to, Humphrey-Hawkins would add $16 to $44 billion to the federal deficit while the Kemp-McClure Jobs Creation Act, which has capital formation as its cornerstone, would add not only an estimated $25 billion to federal revenues but ten million new jobs over a three-year period.

Yet another implication of these huge budget deficits we have seen over the past three years deals with interest rates. Last year, Secretary of the Treasury William Simon predicted that federal, state, and local governments would soak up 80 percent of the investment capital available to cover their deficits. Statistics to the effect that commercial banks increased their holdings of federal debt by 57 percent between January 1975 and March 1976 suggest that were it not for a reduction of business inventories over the same period, "crowding out" would indeed have been a severe problem resulting in a steep rise in interest rates.

Of course, inventory reduction can go on for only so long before shortages or their threat stimulate a demand for short-term credit. As R. Alton Gilbert, writing for a publication of the Federal Reserve Bank in St. Louis, has observed, when that occurs ". . . the Federal Government will not be able to continue financing large budget deficits without putting some upward pressures on short term rates."

How much pressure is, of course, a function of the mix between debt financing and artificial expansion of the money supply. While the news that Federal Reserve Board Chairman Arthur Burns would like to hold any increase in the money supply to 6.5 percent is somewhat encouraging, such a rate is still twice what it should be, given our low productivity increases. Moreover, if such an expansion coincides with big spending programs by the Carter administration and congressional Democrats, it will give rise to further fears about yet another implication of huge budget deficits—inflation.

It has often been said, with truth, that inflation is a hidden tax. Not only do the aforementioned budget deficits cause more money to chase a relatively fixed amount of goods, thus driving up consumer prices and diminishing the purchasing power of our money, but even those lucky enough to secure wage increases pegged to the cost-of-living find themselves owing more tax dollars. And, all the while, congressional spenders responsible for these deficits do not have to vote a tax increase which would alert taxpayers to the real cost of congressional profligacy. In fact, they are able to make themselves look even better by periodically passing tax cuts which, in reality, are nothing more than partial compensation for the tax increases brought on by inflation.

Not too long ago Dr. William J. Fellner, former member of the President's Council of Economic Advisors, did a study on the effects of inflation on taxes. Using 1974 tax figures, Fellner estimated that individual income taxes increased $8 billion and corporate taxes $20 billion, simply because of inflation. Now, 1974 was a particularly bad year for inflation—12.2 percent—but, if we keep on rolling up deficits of $50-$60-$70 billion a year, double digit inflation is sure to return. And with it will come more of what can only be termed "direct taxation without direct representation."

Before leaving the subject of inflation, let me mention a couple of other things. First of all, it is not pure coincidence that as the national debt has increased due to deficit spending, the cost-of-living has gone up an almost equal amount. For example, at the end of 1967, the national debt was $344.7 billion, but by the end of 1975 it had reached $576.6 billion—an increase of 67.6 percent. The cost-of-living meanwhile increased 63.7 percent over the same period, suggesting that if Secretary Simon is right about the national debt increasing $50 billion every six months, double digit inflation is vastly more than an ugly memory.

Secondly, we cannot forget that our current state of energy dependence leaves us vulnerable to inflationary pressures from abroad—particularly from the Middle East. If the Arabs increase the price of their oil by 10 percent or more, as has been predicted, it will necessarily have an effect on prices here at home, especially since the Congress has repeatedly refused to adopt a comprehensive and sensible policy of incentives for the development of alternative energy sources. Instead of eliminating regulations on the price of oil and natural gas and instead of tax reforms that would create the investment capital needed to develop new energy sources, Congress has cut the oil depletion allowance, continued a system of price regulation, and generally refused to provide the incentives necessary for the private sector to remedy the problem. It almost seems as if the Democrat majority in Congress would rather give money to the Arabs than to grant American oil firms a chance to prosper instead. This short-sighted policy simultaneously means a loss of jobs here in the United States while jeopardizing our national security through increasing reliance on an unstable source of oil. The logic of not letting American free enterprise solve the energy problem, as it could if given the chance, simply eludes me.

Finally, on inflation, mention of the Arabs brings to mind President-elect Carter's recent jawboning to the American steel industry about price increases. The big trouble is, his message went to the wrong people. If anyone is responsible for price increases, it is those demanding wage increases in excess of productivity increases; and if anyone is to be jawboned it should be the labor leaders. It will be interesting to see if President Carter lectures the steelworkers when their contracts come up for renewal

next August, or the United Mine Workers, or the Communications Workers, or the Aluminum Workers, or the metal trade union workers or railway employees, all of whom will be negotiating new contracts next year. No one is against the working man making a good wage, one commensurate with his productivity, but when the demands of organized labor exceed that level, higher prices are the inevitable result and everybody is the loser. One needs only look to the example of present-day Great Britain to see what will happen if we keep heading down the road of greater and greater dominance by government and organized labor over the economic system. As one who has been a great admirer of Britain and the British contribution to Western civilization, it is indeed a shame to see that once-proud nation sinking deeper and deeper into the quagmire of excessive taxation, capital starvation and labor union blackmail.

Just as we did 200 and more years ago, we should learn from the British experience, profit from their mistakes but determine not to repeat them ourselves.

Taxes, capital shortfall, interest rates, inflation–these are all profoundly serious implications arising from the phenomenal growth in government spending and the staggering budget deficits of the past three years. But the most important implication of all involves government itself–and its relation to the private sector.

As I mentioned before, not only do all levels of government take over 40 percent of national income in taxes but government expenditures comprise approximately 40 percent of the nation's Gross National Product. In short, government has become a threatening parasite on the American economic scene.

Any government by definition is parasitic. It lives off of the productive energies of the private or voluntary sector. Since, as Thomas Paine noted, government is "the badge of lost innocence," there is a necessity to feed this parasite. And parasites can perform a valuable service for their hosts. A good parasite lives in equilibrium with its host and both parasite and host thrive in this relationship.

All of us carry such parasites in our bodily systems. They actually help us to develop the antibodies that make us more resistant to infection. But other parasites–such as tapeworms–can actually kill their host. Obviously such a relationship is not beneficial to the parasite either.

The dramatic growth of our public (or parasitic) sector in the past quarter of a century (from 26 percent in 1950 to 40 percent in 1975) has created a disequilibrium that has already provided us with symptomatic evidence that the patient is ill: nagging unemployment, high interest rates, and declining productivity. There is, as mentioned, a direct correlation between the growth of the parasitic sector and declining productivity among nations.

That brings us to the question of what can we do to cut the public sector down to size, to keep it within reasonable bounds. But to answer it requires that we look at a bit of history.

Surprising as it may seem today, the federal budget only exceeded $1 billion once before 1917 and stood at $9 billion as late as 1940. The $100 billion mark was not reached until 1962, 173 years after the start of our federal government in 1789. But from there it took us only nine more years to reach $200 billion, another four years to hit $300 billion and only two years after that to surpass the $400 billion figure. At this rate, federal spending will hit $500 billion in the next year or two and could reach $1 trillion by the mid-1980s.

The same dramatic growth can be seen in the size of that national debt. In 1930, the national debt was only $15.9 billion, having been reduced from a high of $25.7 billion during World War I. Just thirty years later, the debt was up to $286.1 billion and by the end of last year it was up to $576.6 billion. Next year, it should crack the $700 billion level, in response to those big deficits, and if the trend continues, it should hit the $1-trillion mark by 1980.

One trillion dollars–the number just rolls off the tip of the tongue. But let me give you an idea of how big a sum that is. If you had started a business at the time of Christ and had lost one million dollars a day since then, it would still take you another 700 years

to lose your first trillion dollars. Or to put the figures another way, the federal budget will cost the family of four an average of $7,380 this year and that the share of the national debt for every man, woman and child in this country comes to $3,250.

So what we have is far more than just a "natural" growth of government and government spending. What we have witnessed is an all-too-rapid acceleration of that growth. Instead of an arithmetic progression we have been witnessing a geometric progression in growth with more of the same likely unless we successfully educate the American people to an understanding of the consequences.

In this same vein, the Democratic platform proposals put forth at their 1976 Convention, proposals that a vast majority of congressional Democrats adhere to—and they are the ones who legislate programs into existence—can only exacerbate our economic problems. Treasury Secretary Simon in a speech last August estimated that:

> The 1976 Democratic Platform might well add another $200 billion in annual government spending and could, if implemented, create serious and protracted economic problems. The costs in the platform could amount to nearly $1,000 in new federal spending for every man, woman and child in the United States and would create real risks of a return to double-digit inflation which would rapidly erode the savings, earnings, and economic security of all Americans.

Lest you think that Simon's statement was simply campaign rhetoric, let me point out again that Humphrey-Hawkins would cost $16 to $44 billion, a tax reduction of the type suggested by President Carter another $10-15 billion, and a federally financed national health insurance scheme at least 50 and probably $100 to $200 billion more. Then if you get into "income maintenance" under welfare reform—a euphemism for guaranteed annual income in liberal jargon—and the multitude of other social welfare schemes, it is easy to see where at least $200 billion more in federal spending could be generated.

The time has come to say no, to put a stop to this business of redistributing wealth under the guise of being a "do gooder." In fact, these social welfare income redistribution schemes do as much harm to recipients as to benefactors. Instead of maintaining pride and having some incentive to produce for oneself and, in the process, for the country, beneficiaries find themselves being locked into a system as insidious and more inefficient than that of the old Tammany Hall. Why should people be productive and self-reliant when they can do better collecting welfare, food stamps and the like; and why should they be independent when the myriad government doles provide so many incentives to be dependent? The process becomes habit-forming and the more people who get hooked, the more temptation there is for others to join them. With the federal welfare faucet flowing freely there will be increasing numbers who will say, if somebody else is collecting something for nothing, why shouldn't we get our share also?

Eventually, if the cycle continues, more and more people will be living on less and less as no one, neither recipients nor those footing the bill, has as much incentive to produce.

When you get right down to it, taking money from one hard-working person and giving it to someone else simply because he doesn't want to work so hard is theft, morally if not legally. Laundering the money, by having the government be the conduit for the transfer, doesn't improve the situation ethically even though it makes it clearly legal. From a moral and spiritual, as well as an economic point of view, it is imperative that we turn away from government as the solution to the nation's problems and turn toward the individual and the free enterprise system. After all, that system has worked well enough in the past to give this nation the highest standard of living in recorded history. And there is every reason to expect that it will do at least as well in the future, provided we adopt policies that discourage inflation, reduce excess regulation and encourage capital formation.

The logical place to start is the federal budget. There is no excuse for $160 billion in deficits over a three-year period. In fact, there is no excuse for any deficits at all, given the fact the nation is at peace and the economy is suffering from over expansion of the money supply already. A balanced budget is not only desirable but practicable. In fact, if Congress had coupled sensible spending cuts with enactment of the Jobs Creation Act we could have had as much as a $41-billion surplus instead of a projected $51-billion deficit in fiscal 1977.

Which brings me to a final point. Congress, not the President, is the ultimate determiner of fiscal policy. If Congress has the power to create an unbalanced budget, it also has the power to give us a balanced budget. These so-called "uncontrollables" in the budget process are "uncontrollable" only because Congress has made them so; and what Congress can do, it can also undo. All that is necessary is a sense of fiscal responsibility and the willpower to act upon it. The day and age of irresponsible Congressmen taking the credit for spending programs and avoiding the blame for their consequences can and should be brought to an end.

Once the budget is balanced, we can move on to the task of cutting down the size of the public sector so that it will pose less of a threat to the economic system that supports it. Anyone who is familiar with the federal bureaucracy knows that it is bloated beyond belief. Reorganization alone is not the answer; reduction is what is needed. Many of the departments and agencies are duplicative, counterproductive, or unnecessary, to say nothing of the fact that they contribute heavily to the federal deficit. Instead of combining them into even bigger superagencies, the emphasis should be on doing away with them or leaving their responsibilities up to the states. As President Ford so eloquently put it: "We should never forget that a government big enough to give us everything we want is a government big enough to take from us everything we have."

To that I can only add that if we want individuals to be able to enjoy the fruits of their own labor, we must understand that individuals, and not society, should be responsible for their own actions. As Justice Louis Brandeis once said, "The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-intentioned, but without understanding."

Hillsdale College's Center for Constructive Alternatives devoted its third seminar this year to discussion of the topic "Between Nothingness and Paradise: Faith," from February 13-18. Joining the students and faculty at Hillsdale were:

Dr. Eric Voegelin
author
"Deformations of Faith"

Dr. Paul Ramsey
Princeton University
"Christian Decision Making"

Dr. Gerhart Niemeyer
Hillsdale College
"The Loss of History"

Dr. Frederick Wilhelmsen
University of Dallas
"Faith and Reason"

The Rt. Rev. Alexander Schmemann
St. Vladimir's Theological Seminary
"The Religious Dimensions of Solzhenitsyn's Writings"

Rev. Edmund Opitz
The Foundation for Economic Education
"The Uses of Reason in Religion"

Rev. Sheldon Smith
Washington Memorial Chapel
"Christ and Culture Today"

Dr. James Hitchcock
St. Louis University
"The Recovery of the Sacred"

In addition, the CCA engaged the series of BBC films narrated by Malcolm Muggeridge, titled "A Third Testament," which deals with the lives of St. Augustine, Blaise Pascal, Soren Kierkegaard, Leo Tolstoy, Dietrich Bonhoeffer, and William Blake. Readings for the course included C.S. Lewis' *Mere Christianity*.